

## Message Text

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PAGE 01 CAIRO 15139 01 OF 02 130326Z

ACTION NEA-10

INFO OCT-01 ISO-00 AID-05 CIAE-00 COME-00 EB-08 FRB-03

INR-07 NSAE-00 USIA-06 TRSE-00 XMB-02 OPIC-03

SP-02 LAB-04 SIL-01 OMB-01 NSC-05 SS-15 STR-05

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R 121607Z SEP 77

FM ANEMBASSY CAIRO

TO SECSTATE WASHDC 9341

LIMITED OFFICIAL USE SECTION 1 OF 2 CAIRO 15139

C O R R E C T E D C O P Y (TEXT)

E.O. 11652: N/A

TAGS: EGEN, EGIN, EG

SUBJ: THE DEBATE ON SUBSIDY CUTS

### 1. SUMMARY AND INTRODUCTION

GOE IS ENGAGED IN MAJOR EFFORT TO EXPLAIN COMPLICATED SUBSIDY SYSTEM AND ITS DELETERIOUS ECONOMIC EFFECTS. AVOWED PURPOSE OF THIS EFFORT IS TO SET STAGE FOR EXPECTED SUBSIDY CUTS AND AT LEAST PARTIALLY COMPENSATING WAGE INCREASES. THIS IS CONSISTENT WITH EARLIER GOE POLICY STATEMENT THAT NEEDED ECONOMIC REFORMS IN EGYPT WOULD HAVE TO INCLUDE PRICE AND WAGE ADJUSTMENTS. FOLLOWING JAN 77 PRICE RIOTS, GOE OFFICIALS INDICATED TO US THAT THEY WOULD CONTINUE PRICE REFORM ACTIVITIES, BUT THAT THEY WOULD BE DIRECTED TO LESS SENSITIVE COMMODITIES AND (CONTRARY TO CURRENT PUBLICITY) WOULD BE HANDLED WITHOUT EXPLICIT PUBLIC DISCUSSION IN MOST INSTANCES. VARIOUS OFFICIAL STATEMENTS, INCLUDING ONE RECENT LENGTHY PRESS INTERVIEW WITH MINPLANNING ABDEL MEGUID, HAVE NOTED THAT GOE HAS INDEED QUIETLY REMOVED OR REDUCED MANY DIRECT SUBSIDIES AND CONSUMER PRICE GUIDELINES, AND THAT REMAINING EXPLICIT SUBSIDIES ARE ON ONLY THOSE FEW COMMODITIES CONSUMED BY BULK OF POPULATION.

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PAGE 02 CAIRO 15139 01 OF 02 130326Z

PROPOSED FURTHER CHANGES IN BASIC PRICE STRUCTURE, WHICH CURRENTLY PROVIDE INDIRECT SUBSIDY OF MANY GOODS, ALSO PRESENT SERIOUS PROBLEM FOR GOVT. GOE IS CASTING ITS APPROACH TO POPULACE AS BEGINNING OF DEBATE ON SENSITIVE ISSUE, WITH FINAL DECISION TO BE REACHED THROUGH POPULAR CONSENSUS. END SUMMARY

2. CURRENT DEBATE ON SUBSIDIES HAS REVEALED THAT, COMPARED

WITH 1974, GOE HAS REDUCED NUMBER OF SUBSIDIZED CONSUMER COMMODITIES TO CONSIDERABLE EXTENT AND INTERNATIONAL PRICE REDUCTIONS HAVE FURTHER REDUCED COSTS TO GOE OF REMAINING SUBSIDIES. ACCORDING RECENT KAISSOUNI PRESS ARTICLE, FOLLOWING IS LIST OF ITEMS CURRENTLY COVERED BY GOE PRICE SUBSIDIES: WHEAT, WHEAT FLOUR, CORN, HORSE BEANS, LENTILS, SESAME SEEDS, EDIBLE OIL, FRSH MEAT, FROZEN MEAT: SUGAR, TEA, BUTAGAS AND INEXPENSIVE CLOTH. EVEN SOME OF THESE COMMODITIES HAVE BEEN PARTIALLY FREED FROM GOVT CONTROL. ADDITIONAL SUPPLIES BEYOND MINIMUM RATION OF SUGAR AND TEA, FOR EXAMPLE, MAY BE PURCHASED AT HIGHER (PRESUJABLY COST-COVERIN) PRICE. RICE IS IN AND OUT OF THIS CATEGORY, DEPENDING UPON ITS AVAILABILITY. SUFFICIENT QUANTITIES OF MEAT AND EDIBLE OIL FOR ALL ARE RARELY AVAILABLE ON MARKET AT LOW, FIXED PRICES, HOWEVER.

3. IN ADDITION GOE SUBSIDIZES MANY SERVICES (E.G., TRANSPORTATION) AND MAINTAINS PRICE GUIDELINES ON OTHER COMMODITIES (BOTH AGRICULTURAL AND MANUFACTURED PRODUCTS), WHICH, ACCORDING TO CONSUMER PROTECTION LAWS, MAY NOT BE EXCEEDED BY SELLERS, WHETHER PRIVATE OR PUBLIC SECTOR. OUR CURRENT OBSERVATIONS INDICATE THAT NUMBER OF GOODS IN THIS PRICEGUIDELINES CATEGORY HAS DECREASED BY ABOUT ONE THIRD TO ONE HALF SINCE 1974. SUCH MIDDLE CLASS STAPLES AS MILK, CHEESE, HONEY AND MACARONI, PRICES OF WHICH WERE ONCE FIXED, ARE NOW AVAILABLE AT MARKET DETERMINED PRICES. THESE COMMODITIES ARE STILL SOLD IN GOVT COOPS AT PRICES LOWER THAN THOSE IN PRIVATE SECTOR SHOPS, LIMITED OFFICIAL USE

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PAGE 03 CAIRO 15139 01 OF 02 130326Z

BUT SUPPLY IS RARELY ENOUGH AT COOPS TO MEET DEMAND. FRUITS AND VEGETABLES ARE ALSO SOLD UNDER THESE PRICE GUIDELINES. PRODUCE WHOLESALERS, MOST IN PRIVATE SECTOR, ARE CURRENTLY BEING BLAMED BY GOE FOR RISE OF FARM PRODUCT PRICES AND GOVT HAS MOUNTED STRONG CAMPAIGN IN PAST TWO WEEKS TO ENFORCE PRICE CONTROLS. PREDICTABLE RESULT OF THIS HAS BEEN DISAPPEARANCE OF SEVERAL PRODUCTS FROM MARKET AS A RESULT OF REDUCED PROFIT MARGINS TO WHOLESALERS AND RETAILERS. GOVT ALSO PROVIDES INDIRECT SUBSIDIES BY CONTROLLING PRICE OF RAW MATERIAL INDUSTRIAL INPUTS. RAW COTTON AND PETROLEUM PRODUCTS FOR INSTANCE, ARE SOLD TO EGYPTIAN INDUSTRIES AT PRICE WELL BELOW WORLD MARKET PRICES. PRICE OF FINISHED GOODS ARE THEREFORE INDIRECTLY SUBSIDIZED.

4. AS WE HAVE OBSERVED BEFORE, BUILD OF EGYPTIANS PROBABLY CONSUME MOSTLY BREAD, SUGAR, TEA, RICE AND VEGATABLES IN THEIR BASIC DAILY DIET. RARELY DOES LOW INCOME GROUP HAVE ENOUGH MONEY TO BUY MEAT, EVEN IF IT IS AVAILABLE AT CONTROLLED PRICES. WHILE GOE HAS THEREFORE OBVIOUSLY MOVED TO FREE UP THE WHOLE PRICE STRUCTURE, THEY HAVE KEP CERTAIN OF MOST SENSITIVE ITEMS UNDER CLOSE CONTROL. CURRENT CAMPAIGN AGAINST PROFITEERING IN VEGABLE MARKET IS YET ANOTHER ATTEMPT

TO REGULATE PRICE OF COMMODITIES CONSUMED BY MAJORITY OF POPULATION. OTHER SUBSIDIES SUCH AS THOSE ON BUTAGAS, SHOES AND TRANSPORTATION HAVE LIKEWISE BEEN PARED. IT IS ALSO IMPORTANT TO NOTE THAT DESPITE CONTINUED EXISTENCE OF SUBSIDIES PRICES OF EVEN RATIONED AND CONTROLLED ITEMS HAVE BEEN INCREASED IN PAST THREE YEARS.

5. IN HIS PRESS STATEMENTS, DEPRIMIN KAISOUNI HAS BEEN MAKING CASE THAT PRICE CONTROLS AND INDIRECT SUBSIDIES ARE DETRIMENTAL IN GENERAL SENSE TO DEVELOPMENT PROSPECTS. AGRICULTURAL AND RAW MATERIAL PRODUCERS HAVE NO INCENTIVE TO EXPAND BECAUSE SALE PRICE OF THEIR PRODUCTS (INDUSTRIAL INPUTS, ARE CONTROLLED. MANY EFFICIENT PUBLIC SECTOR COMPANIES ARE LOSING MONEY BECAUSE OF RETAIL PRICE CONTROLS, HENCE THEY ARE NOT PRODUCING AT, LIMITED OFFICIAL USE

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PAGE 04 CAIRO 15139 01 OF 02 130326Z

OR EXPANDING CAPACITY. THIS MEANS SHORTAGE OF GOODS AND INCREASE IN PRICES RATHER THAN ADEQUATE SUPPLY AT A REASONABLE PRICE.

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PAGE 01 CAIRO 15139 02 OF 02 122141Z  
ACTION NEA-10

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LIMITED OFFICIAL USE SECTION 2 OF 2 CAIRO 15139

6. MUCH PUBLICITY IS BEING GIVEN TO NECESSITY FOR REDUCING SUBSIDIES AND COMPLEMENTARY PROPOSALS TO INCREASE, IN SOME CASES RATHER DRASTICALLY, INCOMES IN ORDER TO COPE WITH SUBSIDY REDUCTIONS. QUIETLY, HOWEVER, THERE ARE THOSE WHO ARE ARGUING PRIVATELY AGAINST DRASTIC REDUCTION OF SUBSIDIES. FORMER MIN

OF FINANCE AND PEOPLES ASSEMBLY MEMBER, AHMAD ABU ISMAIL IS ONE OF THE PROONETS OF MORE GRADUAL APPROACH. CITING ALREADY-ESTABLISHED POLITICAL RISKS IN A RECENT CONVERSATION WITH US, ISMAIL SAID IMF IS "OBSESSED" WITH REDUCTION OF SUBSIDIES AND THIS IS AT ROOT OF GOE PUSH IN THIS DIRECTION. LARGE SUBSIDY INCREASE WAS NECESSARY IN 1974, ACCORDING TO ABU ISMAIL, BECAUSE OF INFLATIONARY GOE POLICIES FOLLOWING OCT 73 WAR. HE AS MIN OF FINANCE INHERITED THESE PROBLEMS BUT REALIZED THAT POLITICALLY A QUICK RETREAT WAS NOT POSSIBLE. ABU ISMAIL SCOFFS AT KAISSEOUNI AND ABDEL MEGUID'S APPEAL TO PUBLIC TO APPROVE SUBSIDY CUTS. IT WILL BE EASIER TO GET ISRAEL OUT OF SINAI, HE SAYS, BECAUSE PEOPLE KNOW THEY WILL SUFFER AND PROMISES OF INCREASED WAGES WILL NOT MATERIALIZE. HE BELIEVES THERE IS NO ALTERNATIVE TO GRADUAL (3-5 YEAR) WITHDRAWAL OF SUBSIDIES AND IMF (AND US) SHOULD NOT PUSH FOR FASTER ACTION. PA, HE INDICATED, WILL EVENTUALLY HAVE TO TAKE STAND AGAINST GOVT ON THIS ISSUE. LABOR LEADERS ARE EXPRESSING SIMILAR VIEWS.

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PAGE 02 CAIRO 15139 02 OF 02 122141Z

7. COMMENT: AS PREVIOUS REPORTING HAS INDICATED, NO FULLY SATISFACTORY OVERALL PRICE INDICATES EXIST FOR EGYPT. AS A QKESULT IT DIFFICULT TO PLACE IMPACT OF PROPOSED INDIVIDUAL PRICE ADJUSTMENT THAT WOULD RESULT FROM SUBSIDY CUTS IN THE CONTEXT OF OVERALL PRICE MOVEMENTS. OFFICIAL CONSUMER PRICE INDICES ARE CONSIDERED TO UNDERSTATE ACTUAL PRICE INCREASES BY A CONSIDERABLE AMOUNT. THUS, ALTHOUGH THE OFFICIAL CONSUMER PRICE INDEX INCREASED BY ABOUT 10 PERCENT AND 15 PERCENT IN 1975 AND 1976 RESPECTIVELY, ACTUAL PRICE INCREASES ARE THOUGH TO HAVE BEEN CLOSER TO 25 PERCENT. IT IS ALSO IMPORTANT TO NOTE THAT PROPOSED SUBSIDY REDUCTIONS WILL NOT IN ALL INSTANCES DIRECTLY RESULT IN PRICE INCREASES THAT WILL BE FULLY ADDITIVE TO EXISTING INFLATION. IN VARYING DEGREES FOR DIFFERENT COMMODITES, PORTIONS OF EXISTING SUBSIDIES ARE ABSROBED IN EXCESS PROFITS OF BLACKMARKETEERS AND MIDDLEMEN. REDUCED SUBSIDIES IN THESE INSTANCES - WHILE RETAIL PRICE GUIDELINES REMAIN IN EFFECT - MAY RESULT PRIMARILY IN REDUCED PROFITS, RATHER THAN HIGHER PRICES TO CONSUMERS. SECONDLY, PART OF EXISINT INFLATION STEMS FROM EXCESS DEMAND FOR COMMODITIES, PRICES OF WHICH ARE NOT CONTROLLED. TO EXTENT REDUCING SUBSIDIES RESULTS IN PRICE INCREASES FOR SOME COMMODITIES, THIS WILL RESULT IN REDUCED CONSUMER PURCHASING POWER DIRECTED TOWARD OTHER COMMODITES AND, HENCE, COULD LOWER RATES OF HMEWITH THESE OTHER COMMODITES. QUITE CLEARLY WHAT IS IMPORTANT HERE IS DIFFERENTIAL IMPACT ON DIFFERENT CONSUMER GROUPS OF DIFFERENT SUBSIDIES. FOR FIRST TIME, GOVT DISCUSSION OF SUBISDY QUESTION INDICATES GOE IS BASING PROPOSED SUBISDY CHANGES ON ANALYSIS OF THESE QUESTIONS.

8. AS NOTED ABOVE, GOVT HAS LINKED ITS DISCUSSION OF  
SUBSIDY REDUCTION TO PROPOSALS FOR AT LEAST PARTIALLY OFF-  
SETTING WAGE INCREASES. HERE ALSO, FULLY SATISFACTORY INFO ON  
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PAGE 03 CAIRO 15139 02 OF 02 122141Z

OVERALL CHANGES IN EGYPTIAN WAGE LEVELS IN RECENT YEARS IS NOT  
AVAILABLE. THE TWO SOURCES OF INFO WE HAVE ARE (A) OFFICIAL  
GOE STATISTICS ON TOTAL WAGES AND SALARIES AND EMPLOYMENT THROUGH  
1975 AND (B) WAGE SCALE FOR US MISSION EMPLOYEES THROUGH  
1977. FORMER INDICATES THAT, FOR ECONOMY AS A WHOLE, WAGES AND  
SALARIES PER WORKER INCREASED 20 PERCENT BETWEEN 1973 AND  
1975 (THE INCREASES WAS 17 PERCENT FOR US MISSION EMPLOYEES)--  
EQUAL TO INCREASE IN OFFICIAL COST-OF-LIVING INDEX.  
HOWEVER, TO EVALUATE CHANGES IN REAL LEVELS OF WELL BEING,  
IT IS NECESSARY TO ADD VALUE OF SUBSIDIES TO WAGES (EQUAL TO  
ABOUT ANOTHER 25 PERCENT INCREASE IN WAGES) AND TO NOTE THAT  
ACTUAL COST-OF-LIVING INCREASES WERE ALSO ABOUT 25 PERCENT  
GREATER THAN OFFICIAL INDEX. NET EFFECT IS TO SHOW THAT ON AVERAGE  
THE REAL LEVEL OF EGYPTIAN STANDARD OF LIVING DID NOT CHANGE  
SIGNIFICANTLY BETWEEN 1973 AND 1975. OBVIOUSLY IT IS ESSENTIAL  
THAT ANALYSIS OF AVERAGE CHANGE BE DISAGGREGATED BY ECONOMIC  
AND SOCIAL SECTOR. THUS BENEFICIARIES OF DIRECT SUBSIDIES HAVE  
PRIMARILY BEEN IN URBAN AREAS, WHILE THE GREATEST RATE OF WAGE  
INCREASE HAS OCCURED IN THE SECTORS HAVING MORE PRIVATE SECTOR  
INVOLVEMENT (E.G., 50 PERCENT AND 44 PERCENT WAGE INCREASE  
IN CONSTRUCTION AND AGRICULTURE BETWEEN 1973 AND 1975,  
VERSUS 8 PERCENT AND 13 PERCENT IN INDUSTRY AND TRANSPOR-  
TATION, RESPECTIVELY). TO SOME EXTENT, PAST IMPACT OF WAGES  
AND SUBSIDIES HAVE BALANCED ONE ANOTHER IN SOME SECTORS.  
THE CHALLENGE FACING THE GOE AS IT CONSIDERS FUTURE  
SUBSIDY REDUCTIONS AND WAGE INCREASES IS TO KEEP INDIVIDUAL  
SECTORS OR CLASSES FROM BEING ADVERSELY AFFECTED BY NET  
IMPACT OF THESE CHANGES.

9. DISCUSSION OF SUBSIDY ISSUE LIKELY TO CONTINUE FOR  
SOME TIME. SALEM GOVT IS TRYING MIGHTILY TO INVOLVE  
BROADEST SPECTRUM OF POPULATION IN DECISION TO DECREASE  
COMMODITY SUBSIDIES, REMEMBERING VIOLEN REACTION OF LAST  
JAN TO PRPOSED CUTS. DANGER OF POLITICAL UPHEAVAL IS CLEAR  
AND APPARENT, AND GOE OBVIUSLY IS PROCEEDING CAUTIOUSLY ON  
YET FURTHER,OVERT ACTION ON THIS IMPORTANT ISSUE.  
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PAGE 04 CAIRO 15139 02 OF 02 122141Z

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## Message Attributes

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**Secure:** OPEN  
**Status:** NATIVE  
**Subject:** THE DEBATE ON SUBSIDY CUTS  
**TAGS:** EGEN, EFIN, EG  
**To:** STATE  
**Type:** TE  
**vdkgvkey:** odbc://SAS/SAS.dbo.SAS\_Docs/66178648-c288-dd11-92da-001cc4696bcc  
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